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OPEC: Moving Further Into the Red

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An Intelligence Assessment

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GI 82-10212
October 1982

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OPEC: Moving Further Into the Red [redacted]

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An Intelligence Assessment

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The author of this paper is [redacted] Economics Division, Office of Global Issues. Comments and queries are welcome and may be directed to the Chief, Trade and Monetary Branch, Economics Division, [redacted]

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Key Judgments

Information available as of 16 September 1982 was used in this report.

Continued weakness in the oil market has caused us to raise our estimate of the 1982 OPEC current account deficit from the $1 billion projected in April to at least $17 billion. The increase could be greater if the expected fourth-quarter economic recovery in the industrialized countries fails to materialize. This year's payment shortfall contrasts markedly with 1980 and 1981 surpluses of $106 billion and $50 billion, respectively. Only five OPEC countries are likely to run a surplus in 1982—Saudi Arabia, Kuwait, Qatar, the United Arab Emirates, and possibly Iran. The expected soft oil market in 1983, together with reduced investment earnings and mounting debt service payments, should push the OPEC deficit to about $25 billion next year.

The deterioration of their finances is already slowing the growth of OPEC countries' imports from the West and has forced the richer Persian Gulf states to consider cutting back their bilateral aid, including aid to antileftist insurgent groups, pro-Western African states, and other moderate countries peripheral to Gulf security interests. It has not meant, however, a reduction in aid to key Arab states, nor has it translated into a shortage of loanable funds in international capital markets to meet LDC demands. These could become more serious issues in 1983, particularly if oil prices decline much further.

The situation could be a good deal worse than our baseline projection indicates if oil prices decline next year—a development we cannot rule out. The price-decline scenario could well materialize if the Iran-Iraq war ends and the participants move to regain their prewar export levels. The Saudis, along with other OPEC states, would have to cut production substantially to keep oil prices from falling. Mexico's oil-production policy could also adversely affect the market. We cannot completely rule out the chance of a price collapse, a development that would pose serious risks to the political stability of major oil-exporting countries. A collapse in oil prices would also impose new strains on the international financial system.

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Table 1
OPEC: Current Account Balance, by Country

Billion US $

	1979	1980	1981 [a]	1982 [b]	1983 [b]
OPEC [c]	**56**	**106**	**50**	**−17**	**−25**
Algeria	−2	2	−1	−3	−1
Ecuador	−1	NEGL	−1	−1	−1
Gabon	NEGL	1	NEGL	NEGL	NEGL
Indonesia	2	5	NEGL	−7	−8
Iran	12	−1	−2	4	4
Iraq	8	8	−18	−21	−20
Kuwait	14	14	9	2	2
Libya	3	10	−3	−6	−2
Nigeria	1	4	−7	−6	−7
Qatar	2	4	4	4	4
Saudi Arabia	14	48	55	14	4
UAE	4	9	8	4	1
Venezuela	NEGL	4	3	−2	−1

[a] Estimated.
[b] Projected; based on a unified benchmark price of $34 per barrel.
[c] Because of rounding, components may not add to the totals shown.

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Table 2
OPEC: Oil Export Earnings, by Country

	1981			1982 [a]		
	Volume *(thousand b/d)*	Average Price *(US $/b)*	Revenue *(billion US $)*	Volume *(thousand b/d)*	Average Price *(US $/b)*	Revenue *(billion US $)*
OPEC [b]	**20,515**	**33.80**	**253.1**	**17,022**	**32.62**	**202.7**
Algeria	847	39.53	12.2	828	35.86	10.8
Ecuador	132	34.23	1.6	110	32.90	1.3
Gabon	138	30.48	1.5	138	29.68	1.5
Indonesia	1,210	33.69	14.9	901	33.68	11.1
Iran	849	36.79	11.4	1,650	28.63	17.2
Iraq	781	37.20	10.6	740	34.76	9.4
Kuwait	1,044	35.01	13.3	706	32.04	8.3
Libya	1,043	41.22	15.7	1,112	35.57	14.4
Nigeria	1,207	37.93	16.7	1,313	35.17	16.9
Qatar	409	36.93	5.5	388	34.52	4.9
Saudi Arabia	9,614	31.55	110.7	6,467	32.22	76.1
UAE	1,462	35.52	19.0	1,204	34.00	14.9
Venezuela	1,779	30.50	19.8	1,465	29.71	15.9

[a] Projected.
[b] Because of rounding, components may not add to the totals shown.

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OPEC: Moving Further Into the Red [redacted]

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The Changing Estimate

The financial position of OPEC countries is deteriorating faster than we thought would be the case earlier this year. We now expect the group as a whole to run at least a $17 billion current account deficit in 1982, rising to perhaps $25 billion next year (see table 1). In April our forecast pointed to a slight deficit this year and an $8-17 billion deficit in 1983. [redacted] Oil revenues this year are likely to run $203 billion instead of the $221 billion we were projecting last spring (see table 2). [redacted]

Two factors are primarily responsible for this change: depressed oil export volume and prices. On the volume side, demand for OPEC oil has not recovered as expected. Economic growth in major industrial countries and oil-importing LDCs is proving lower, and a much larger proportion of demand is being met through inventory drawdowns. During the past six months or so, excess non-Communist country inventories have been drawn down by roughly 2 million barrels per day (b/d). Since many non-OPEC producers are operating at close to capacity, the above-normal inventory drawdown has come at the expense of OPEC countries. [redacted]

Average prices for OPEC oil have also declined somewhat faster than initially expected. At present, the weighted average price of a barrel of OPEC oil is about $32.50. Six months ago the average price stood at $33.10 per barrel. Most of the price slide occurred in the aftermath of the OPEC meeting in March when the Saudis forced a tentative agreement on crude price differentials. The most extreme price swing has been for high-quality Libyan and Nigerian crudes. In the case of Libya, official crude oil prices have declined from $37 per barrel in January to $35.50 per barrel in July. [redacted]

These factors have already cut sharply into the OPEC current account balance. We estimate that the cartel ran a $2 billion current account deficit during the first six months of this year. This compares with an estimated $15 billion surplus during the preceding six-month period. The financial drain, moreover, was somewhat greater than these figures imply. OPEC countries borrowed nearly $8 billion on the Euromarket in the first six months of 1982. This borrowing, if annualized, would exceed last year's record level of about $14 billion. As a result, we estimate that the drawdown in official foreign assets during January-June 1982 (less the Saudis, who added to reserves) amounted to perhaps $10-15 billion. [redacted]

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Sensitivity Factors

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Forecasting OPEC current account balances is risky even under stable conditions. The most sensitive elements in the projections are oil export volume and prices; even small changes in these elements result in large shifts in the overall balance. In contrast, the current account balance is much less sensitive to changes in OPEC import rates. For example:

- *A 1-million-b/d change in annual oil export volume changes the current account balance by $12 billion.*
- *Each dollar change in the yearly average oil price changes the current account by more than $6 billion.*
- *A 1-percentage-point change in OECD GNP growth alters demand for OPEC oil by 700,000 b/d, worth about $8 billion at current prices.*
- *Each 1-percentage-point change in OPEC's import volume or import prices, however, would alter the current account balance by only $1.6 billion.* 25X1

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Alternative Current Account Estimates

There is a wide discrepancy among recent estimates of the OPEC current account position for 1982 and 1983. The following table summarizes these projections; where necessary we have adjusted them to assure comparability in coverage:

Billion US $

	1982	1983
OECD Secretariat (July 1982)	+3	+10
Morgan Guarantee Trust (September 1982)	0	−3
OPEC Secretariat [a] (September 1982)	−20	−4
US Department of the Treasury, Office of Development Nations Finance (August 1982)	−9	−2 [b]
Central Intelligence Agency (September 1982)	−17	−25

[a] The OPEC Secretariat projected a 1982 deficit of $10 billion and a surplus of $6 billion for 1983. These estimates, by all indications, did not include official transfer outflows, which we estimate to be $11 billion this year and $10 billion next year.
[b] Currently being revised downward to reflect the anticipated boost in Mexican oil production.

With the exception of the OECD, all forecasters put OPEC into current balance or deficit this year. Variations among these latter estimates, while wide in absolute value, stem from relatively small differences in underlying assumptions:

- ***Oil revenue** projections vary from $201 billion to $218 billion. Our estimate of $203 billion is within 1 percent of the Treasury ($201 billion) and OPEC Secretariat ($206 billion) estimates.*
- ***OPEC import** projections, with one exception, range from $170 to $174 billion. Most of the estimates, including our own, forecast nominal import growth on the order of 8 percent. The Department of Treasury projects import growth at 3 percent, and this difference largely underlies their $162 billion estimate for 1982 OPEC imports.*

Estimates for the 1983 OPEC current account exhibit a much greater variation, in part because of a compounding of the differences in assumptions for 1982. Our 1983 estimate points to by far the largest deficit, in large measure because of our lower expectations of the demand for OPEC oil.

The nature of the problems faced by OPEC countries will not differ substantially should the 1983 current account deficit prove to be well below the $25 billion level we project. A stronger oil market would allow the more financially pressed OPEC members to reduce foreign borrowings and/or asset drawdowns or implement less severe austerity measures. Reduced OPEC borrowing on international financial markets would not necessarily benefit other financially hard-pressed Third World borrowers since it would be accompanied by higher costs for OPEC oil.

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Little Relief in Sight

We expect this pattern of large and growing deficits to persist through this year and into 1983. In preparing our current estimate, we made certain key assumptions about factors affecting demand for OPEC oil:

- *The business cycle.* We have assumed that a moderate economic recovery will begin in major industrialized countries in fourth-quarter 1982. We assumed that the latest forecast by the Organization for Economic Cooperation and Development (OECD) for industrial country growth—approximately 2.5 percent—will prove correct.

- *The inventory cycle.* We have assumed that the above-inventory adjustment process will be completed by the end of third-quarter 1982, a factor that should by itself increase the demand for OPEC oil by 1 million b/d.

Taken together, these conditions should result in demand for OPEC oil approximating 21-22 million b/d toward yearend and remaining close to that level throughout 1983. We expect price levels to hold steady in the current $32.50- to $33.00-per-barrel range. These assumptions imply an increase of $18 billion in OPEC oil export earnings in 1983.

We have made some rough estimates on how oil exports could be allocated among OPEC countries during the period of late 1982 through 1983. In preparing these figures we assumed that Iran and Iraq together will continue to export about 2.6 million b/d, the level reached during the past few months. We also assumed that others in the group will split remaining demand for OPEC oil in roughly the proportions they currently hold. In these circumstances, Saudi Arabia would export about 6.3 million b/d next year. This compares with 6 million b/d exported in July and 7 million b/d in first-half 1982. For 1982 as a whole, we project Saudi exports will average about 6.5 million b/d.

OPEC countries are already sharply curtailing import growth in response to past falls in oil revenues (see table 3). We estimate that import volume growth will slow to about 8 percent in 1982, contrasted with the estimated 25-percent gain recorded last year; and we

Table 3
OPEC: Imports

	1982 Value *(billion US $)*	Percentage Change of Volume Over Previous Year	
		1981	1982
OPEC	**173.2**	**25**	**8**
Algeria	12.0	17	4
Ecuador	2.5	5	2
Gabon	0.9	20	10
Indonesia	19.2	32	15
Iran	10.6	−3	5
Iraq	20.7	63	4
Kuwait	8.8	13	14
Libya	15.5	55	−3
Nigeria	18.4	26	0
Qatar	1.4	12	10
Saudi Arabia	40.0	21	18
UAE	9.2	11	10
Venezuela	14.0	10	6

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expect this slowdown to continue into 1983. The countries will benefit by reduced inflation; available data indicate that the dollar price of goods purchased by OPEC countries increased by less than 1 percent during the first half of 1982. Even so, the trade surplus this year will shrink substantially as the combined effect of lower import prices and volume growth fail to offset the large decrease in oil revenues. There will be virtually no change in next year's trade balance; a modest increase in export revenues is nearly offset by greater import costs. In addition, investment income earnings will decline in both years because of reserve drawdowns to finance deficits plus the overall decline in interest rates. 25X1

Country Positions

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If conditions develop as we now anticipate, all but a few OPEC countries will be in deficit this year. Most of the deficit countries are already in financial trouble

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and these problems could become intense, especially if the banking community moves to constrain lending to these countries. [redacted]

Nigeria. We estimate that Nigeria's 1982 current account deficit will exceed $6 billion, even factoring in some recovery in oil production in the second half and a fall in import costs resulting from recent austerity measures. With official reserves equal to only about one month's worth of imports, Lagos no longer has the option of drawing on foreign exchange holdings to cover the deficit this year. [redacted] Lagos has undisbursed funds available from previous borrowings. If oil prices soften further, Nigeria could experience some debt problems by late 1983. Although still relatively small, the external debt is nearly six times the yearend 1977 level. Commercial arrears are already building up; some local businessmen believe unpaid obligations could total nearly $2 billion. [redacted]

Given this situation, Lagos may have insufficient funds to cover normal import needs and debt repayment. Embassy sources report that Lagos is issuing less than $1.2 billion in import licenses a month, compared with the nearly $2 billion monthly average in the first quarter of the year. The smaller volume of consumer goods in the marketplace in late 1982 and early 1983, coupled with the crackdown on smuggling, will push inflation above the already high rate. Meanwhile, reduced economic activity is boosting urban unemployment. It is our judgment that any further decline in the economy will damage Shagari's chances for reelection. As a result, we believe that Shagari will be inclined to relax austerity measures prior to elections next summer. [redacted]

Indonesia. The prospect of declining oil and nonoil export revenues has forced Indonesia to adopt fiscal belt tightening in the midst of parliamentary and presidential election campaigns. In contrast to the Nigerian situation, President Soeharto apparently feels he is politically secure enough to take such steps. In any case, we estimate deficits of $7-8 billion in 1982 and 1983, even if Jakarta slows import volume growth to 15 percent this year and to 10 percent next year. In 1981 import volume rose 32 percent. Although international bankers consider Jakarta a good risk, we question whether they would be willing to increase their exposure by $7 billion or so a year for very long. If the bankers do restrict access to funds, President Soeharto will be forced to cut import growth further and prolong the current development program. [redacted]

Venezuela. Given the extremely soft oil market, Venezuela is another potential candidate for debt problems. To ease debt-related pressure, Venezuela has aggressively tried to convert its large short-term debt into medium- or long-term debt. [redacted] Caracas has largely been successful in this restructuring effort. The government is also cutting spending to prevent larger budget and current account deficits, resurgent inflation, and additional foreign borrowing. Austerity, however, will cause continued economic stagnation for the oil-dependent economy. With elections scheduled for 1983, the government will be hard pressed to continue this effort. Indeed, we expect that the government will probably relax its tight monetary and fiscal policies to spur growth. This, in turn, would aggravate inflationary pressures and increase the need for foreign borrowing. [redacted]

Libya. [redacted]

The Qadhafi regime has also implemented a series of austerity measures to slow the foreign exchange drain. The resulting income losses may be adding to existing disaffection generated by unpopular measures enacted

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by the regime last year. For example, the regime has closed privately owned stores, replacing them with state-owned operations and distribution networks. The inexperience and inefficiency of this bureaucracy, compounded by subsequent financial problems, have contributed to food supply dislocations. [redacted]

Iraq. Iraq is weathering the combination of soft oil prices and war-reduced oil export volume on the strength of some $20 billion in aid from other Persian Gulf Arab countries, primarily Saudi Arabia. Even so, Baghdad has had to draw down official foreign assets by an estimated $13 billion since yearend 1980; these reserves currently stand at about $18 billion. To limit the financial drain, Baghdad is now curtailing some of its development program. The problem is that much of Saddam's popular support has hinged on his ability to insulate the consumer from the war. The regime, therefore, will give priority to ensuring an adequate supply of basic necessities. If the oil market develops as we now expect, and Iraqi export volume approximates 750,000 b/d, Baghdad could face a current account deficit next year of as much as $20 billion. [redacted]

Iran. We expect Iran to run a small current account surplus this year if Tehran can maintain oil export volumes at about 2 million b/d. A small surplus could be maintained next year in these circumstances, even allowing for a 10-percent rise in import volume. An increase of this size would still leave imports well below the levels achieved before the revolution. To finance much larger increases, Tehran would have to draw on its official assets, which amount to about $10 billion—including about $2 billion in gold. As things now stand, the international banking community shows no willingness to lend to the Khomeini regime. On balance, we believe economic growth will remain limited, in part because of clerical interference with management of the economy and because of the limited development objectives of the Khomeini government. [redacted]

The Special Saudi Case

Saudi Arabia's current account position is undergoing the most extreme swing within OPEC. We estimate that their surplus this year will approximate $14 billion, compared with $55 billion in 1981. The account, however, may already be near deficit on a monthly basis. We tentatively estimate that during January through June 1982 the surplus was about $12 billion. If oil exports recover to the 6.3-million-b/d level we now project for 1983 and import volume growth declines to 10 percent, Riyadh will experience a 1983 current account surplus of not more than $4 billion. Even so, Riyadh would have to draw on its foreign exchange reserves because of substantial financial commitments that are not included in the current account balance. The largest is Riyadh's multibillion-dollar aid program, including an estimated $3 billion for Iraq. In addition, Saudi Arabia has traditionally had large private capital outflows. Altogether, meeting these financial commitments would require the Saudis to draw down their foreign exchange holdings by perhaps $8 billion next year, if the oil market and Saudi oil exports develop as we now expect. [redacted] 25X1

The situation could be substantially different. Riyadh, for example, might have to cut oil production further in order to maintain the current price structure. We examined several possibilities, including a scenario in which Saudi exports drop to 5 million b/d next year. 25X1 Assuming no change in import growth from our baseline projection, the Saudis would face a deficit of about $12 billion in their current account balance. Riyadh's other commitments would boost the financial gap to nearly $20 billion. Before the deficit reached that level, however, we believe that Riyadh would move to trim foreign exchange expenditures, including a slowdown in the rate of development spending; there would be limits to the slowdown, though, due to rising expectations and the desire to protect private interests. [redacted] 25X1

Bilateral aid—worth about $6 billion—would surely be cut. The only program that we expect would be largely untouched is the Iraqi aid effort, as well as lending to multilateral institutions—especially the International Monetary Fund (IMF). Aid to countries such as Oman, Mauritania, Tunisia, Zambia, and The Gambia would be questioned. Table 4 shows the distribution of Saudi aid and the degree to which recipients rely on the aid. [redacted]

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Table 4
Saudi Aid: Size and Importance

Million US $

Recipient	Current Account 1980	Current Account 1981	Saudi Aid Disbursements, 1980	Saudi Aid as a Percent of Total Aid Received in 1980
Arab states				
Bahrain	128	211	10	24
Egypt	−500	−1,994	350	14
Jordan	−935	−778	515	20
Lebanon	475	850	60	18
Mauritania	−277	−360	180	62
Morocco	−1,525	−1,942	670	39
North Yemen	−478	−727	290	29
Oman	1,144	1,182	50	16
Sudan	−854	−740	365	32
Syria	−2,159	−4,175	880	19
Tunisia	−285	−489	50	11
Non-Arab Islamic states				
Bangladesh	−1,521	−1,397	75	6
Djibouti	13	−4	30	15
Guinea	−74	−105	10	10
Pakistan	−1,010	−882	315	20
Somalia	−74	−50	145	20
Turkey	−3,660	−2,300	210	11
Other states				
Liberia	−86	−69	10	9
Sri Lanka	−800	−654	65	14
Zimbabwe	−283	−554	5	1
Special case				
Iraq	7,500	−17,800	3,000	42

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[redacted] 25X1

Price-Collapse Scenario

A key element in sustaining the current OPEC price structure during the next 18 months will be the willingness of the OPEC members to maintain some form of production sharing. Given the financial strain faced by most members of the cartel, there will be considerable pressure to maximize production and exports, without regard to the impact on each other. The production-sharing problem could explode if the Iran-Iraq war ends and both countries move quickly to boost oil exports sharply. The financial crisis in Mexico will force it to increase oil production. By mid-1983 Mexican exports could increase by as much as 300,000 b/d. Under such circumstances Saudi Arabia would have to cut production sharply to avoid a major price break. [redacted] 25X1

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[redacted]

[redacted] we do not know how far oil prices might fall. For the sake of argument, we have examined a case in which the OPEC weighted average price drops to $20 per barrel. Table 5 shows what the 1983 current account balances of OPEC members would be if they maintained the same import patterns we assumed earlier. This scenario also assumes that oil export volumes will remain at projected levels, with the exception of Iran and Iraq. In most cases, the deficits would be enormous and unsustainable. Nigeria and Indonesia, for example, would incur deficits of $13-14 billion; the Saudi deficit would reach $26 billion. With oil prices at $20 per barrel, Mexico would face a $4 billion decline in oil revenues even if it managed to raise export volume by 300,000 b/d. [redacted]

We cannot project the adjustment process with any precision. Since their borrowing capability is limited, most oil exporters would require massive financial assistance or face the prospects of very large reductions in imports. To maintain their current account deficit at the 1982 level, for example, Nigeria and Venezuela would have to reduce import volume next year by one-third unless special aid were forthcoming. The economic austerity associated with import cuts of such magnitude would almost certainly spark some degree of political instability. [redacted]

Table 5
OPEC: The Price-Collapse Scenario [a]

	OPEC Current Account Balance *(billion US $)*	Approximate Import Volume Reduction Needed To Maintain 1982 Balance *(percent)*
OPEC [b]	**−101.3**	**33**
Algeria	−6.0	20
Ecuador	−1.6	5
Gabon	−0.6	50
Indonesia	−12.6	20
Iran	−0.5	20
Iraq	−14.0	
Kuwait	−2.1	35
Libya	−10.5	20
Nigeria	−14.1	30
Qatar	1.9	80
Saudi Arabia	−25.9	70
UAE	−5.7	70
Venezuela	−8.8	35

[a] Assumes average weighted OPEC oil price of $20 per barrel.
[b] Because of rounding, components may not add to total shown.

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[redacted]

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To avoid that kind of austerity, the exporting countries might try another round of oil price cutting to boost export volume, setting off another downward price spiral. International financial stability would obviously be greatly affected. The position of some oil-importing countries would improve substantially. The position of other non-OPEC oil-exporting countries—such as Mexico, Egypt, the United Kingdom, and Norway—would suddenly deteriorate. Countries losing access to OPEC aid would also face hardships. The impact on the system as a whole is uncertain and would depend both on how the situation unfolds and on the flexibility of the international financial community. [redacted]

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